Hunland Trade Kft
Hungary, Agribusiness

SCOPE

STABLE

BB-

Key metrics

			Scope estimates	
Scope credit ratios	2021	2022	2023E	2024E
Scope-adjusted EBITDA/interest cover[1]	6.8x	-78.4x	-10.4x	-10.1x
Scope-adjusted debt/EBITDA	6.1x	5.4x	6.1x	6.0x
Scope-adjusted funds from operations/debt	-36%	18%	6%	13%
Scope-adjusted free operating cash flow/debt	9%	11%	-17%	7%

Rating rationale

The ratings are supported by Hunland Trade's very strong debt protection, its vertical integration within the Hunland Group and its leading position among Hungarian livestock exporters. Hunland benefits from a good geographical diversification of customers.

The main rating constraints relate to the high indebtedness and the minor role of livestock export in the Hungarian economy.

Outlook and rating-change drivers

The Stable Outlook incorporates our view that key credit metrics over the next three years will improve overall, with Scope-adjusted debt/EBITDA at 5.0x-6.0x and with very strong debt protection reflecting the higher interests received over the interests paid. It also incorporates Hunland Trade's position as the leading Hungarian livestock exporter and our expectation that Hunland Trade's EBITDA margin will remain stable at around 2%.

A positive rating action is deemed remote but could be warranted by an improved business risk profile, e.g. through improved operating margin such as a Scope-adjusted EBITDA margin of over 3.5%. Likewise, rating upside could be seen through a significant improvement of the company's leverage, e.g. through a Scope-adjusted debt/EBITDA close to 4.0x on a sustained basis.

The rating could come under pressure if Scope-adjusted debt/EBITDA rose above 6.0x, for example as a result of significantly lower contributions to earnings from cattle and pig sales.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
14 Dec 2023	Upgrade	BB-/Stable
23 Dec 2022	Outlook change	B+/Positive
02 Feb 2022	Affirmation	B+/Stable

[1] The negative Scope-adjusted EBITDA/interest cover results from the negative net cash interest paid position.

Ratings & Outlook

Issuer	BB-/Stable
Guaranteed senior unsecured bond	BB-

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Related Methodology

General Corporate Rating Methodology; October 2023

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Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Very strong expected interest coverage due to net interest received • Vertical business integration enabling Hunland Trade to be less exposed to economic downturns • Leading Hungarian livestock exporter • Good geographical diversification on the customer side • Stable but low profitability	• High expected leverage (Scope-adjusted debt/EBITDA) • Minor role of livestock exports in the Hungarian economy • Eastern Europe and Hungary are small livestock producers, although there is some potential for development in Eastern Europe • Lower exports of live animals and lower prices for cattle and lamb • High receivables and pressure on net working capital • Lower geographical diversification on the supplier side

Positive rating-change drivers	Negative rating-change drivers
• Scope-adjusted debt/EBITDA consistently close to 4.0x • Improving business risk profile, e.g. as demonstrated by improved profitability on a sustained basis	• Scope-adjusted debt/EBITDA sustained above 6.0x

Corporate profile

Founded in 1992 and headquartered in Bugyi, Hungary, Hunland Trade Kft has a prominent role in the global livestock and meat trade. It sells and buys livestock (breeding cattle, slaughtering cattle, sheep, lambs, goats, pigs and piglets), mainly to supply the group's agriculture companies. It supplies beef, pork and lamb meat as well as poultry meat. Its only subsidiary, with an 88% stake, is Hunland Trans Kft. The company is fully indirectly owned by Joseph Janssen (74.69%) and Suzanne Janssen (25.31%).

Financial overview

			Scope estimates		
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover[2]	6.8x	-78.4x	-10.4x	-10.1x	-10.5x
Scope-adjusted debt/EBITDA	6.1x	5.4x	6.1x	6.0x	5.4x
Scope-adjusted funds from operations/debt	-36%	18%	6%	13%	17%
Scope-adjusted free operating cash flow/debt	9%	11%	-17%	7%	4%
Liquidity (internal and external)	<100%	>200%	>200%	>200%	>200%
Scope-adjusted EBITDA in EUR '000s					
EBITDA	7,524	7,721	8,708	8,277	8,757
Operating lease payments in respective year	0	0	0	0	0
Disposal gains (losses) on fixed assets	565	41	0	0	0
Scope-adjusted EBITDA	**8,089**	**7,762**	**8,708**	**8,277**	**8,757**
Scope-adjusted funds from operations in EUR '000s					
EBITDA	7,524	7,721	8,708	8,277	8,757
less: net cash interest paid	-1,186	99	834	817	837
less: cash tax paid as per cash flow statement	-432	-593	-450	-395	-430
add: depreciation component of operating leases	0	0	0	0	0
add: dividends received from equity	880	0	395	395	395
Other changes	-24,705	447	-6,024	-2,794	-1,480
Funds from operations	**-17,919**	**7,673**	**3,463**	**6,301**	**8,079**
Free operating cash flow in EUR '000s					
Funds from operations	-17,919	7,673	3,463	6,301	8,079
Change in working capital	23,951	-4,646	-9,987	-116	-3,670
Non-operating cash flow	0	0	0	0	0
less: capital expenditure (net)	-883	1,562	-2,785	-2,460	-2,610
add: disposal gains (losses) on fixed assets	-565	-41	0	0	0
Free operating cash flow (FOCF)	**4,584**	**4,548**	**-9,309**	**3,726**	**1,798**
Net cash interest paid in EUR '000s					
Net cash interest per cash flow statement	1,186	-99	-834	-817	-837
add: interest component, operating leases	0	0	0	0	0
Change in other items	0	0	0	0	0
Net cash interest paid	**1,186**	**-99**	**-834**	**-817**	**-837**
Scope-adjusted debt in EUR '000s					
Reported gross financial debt	67,343	61,428	64,616	64,576	64,267
less: cash and cash equivalents	-18,256	-19,537	-11,227	-14,809	-16,982
add: cash not accessible	213	110	110	110	110
add: pension adjustment	0	0	0	0	0
add: operating lease obligations	0	0	0	0	0
Scope-adjusted debt	**49,300**	**42,001**	**53,499**	**49,877**	**47,395**

[2] The negative Scope-adjusted EBITDA/interest cover in 2022, 2023, 2024 and 2025 results from the negative net cash interest paid position.

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Environmental, social and governance (ESG) profile[3]

Environment		Social		Governance	
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)		Labour management		Management and supervision (supervisory boards and key person risk)	
Efficiencies (e.g. in production)		Health and safety (e.g. staff and customers)		Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)	
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)		Clients and supply chain (geographical/product diversification)		Corporate structure (complexity)	
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	

Legend
Green leaf (ESG factor: credit positive)
Red leaf (ESG factor: credit negative)
Grey leaf (ESG factor: credit neutral)

No dedicated ESG strategy

Hunland Trade has no dedicated ESG strategy. The livestock industry has a huge carbon footprint. According to the UN, it represents approximately 14% of global greenhouse gas emissions. More than 20% of global emissions stem from agriculture and land use. Within agriculture, cattle farming is the most environmentally intensive form of food conversion: it requires significant land resources for feed production and water; it also releases methane. Even if methane stays in the atmosphere less long than carbon dioxide does, it has a considerably greater global warming potential. 83% of all agricultural land is dedicated to livestock, and meat and dairy contribute to 60% of agriculture's greenhouse gas emissions. The increasing awareness of the livestock industry's carbon footprint has led to a new way of eating. The importance of animal welfare is also increasing. The livestock industry is going to experience regulatory pressure but also changes in consumer preferences, who are increasingly looking for plant-based substitutes but also healthier, more natural, organic and antibiotic-free meat products.

[3] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: B+

Hunland Trade's business risk profile is supported by its market position as Hungary's leading livestock exporter, though profitability and diversification are negative rating drivers.

Animal production accounts for one-third of agricultural output in Hungary

According to Eurostat, animal output accounts for one-third of Hungary's agricultural output and is the country's second biggest source of agricultural income, while crop output accounts for half of agricultural output and is the top source of agricultural income. Within animal output in Hungary, poultry ranks first (12% by average agricultural output), followed by pigs (10%), milk (8%), eggs (2%), cattle (4%), and sheep and goats (1%). Thus, the livestock market on which the issuer depends (cattle, pigs and sheep) accounts for around 15% of agricultural production, which is half of Hungary's animal output and half the size of its cereal production market.

Minor role of livestock exports in Hungary's economy

Hungarian exports of agricultural products, at EUR 9.6bn in 2020, are small compared to goods and services exports of EUR 107bn (source: Eurostat). Commodities made up one-third of agricultural product exports in 2020, with 90% going to the EU.

Eastern Europe and Hungary are small livestock producers…

Europe is the world's second largest livestock producer by tonnes of protein (behind Asia) through cattle, pork and beef for Western European customers. Eastern Europe, by contrast, accounts for only 20% of European production and 4% of worldwide production.

With 8.5m head of livestock in 2019, Hungary ranks 15th in Europe, far behind first-ranking Spain with 102.1m head. Excluding Western European countries, Hungary comes in fifth among the top five behind Romania, Poland, Greece and Serbia.

The last two livestock surveys by the European Commission found a decline in the main producing EU member states, except for Poland and Spain. This trend is expected to continue until 2030, accompanied by a partial shift to Poland, Hungary and the Czech Republic.

… but potential for development in Eastern Europe

Hunland Trade expects production from Eastern Europe to grow thanks to land availability. Indeed, livestock production is the world's largest user of land, either directly through grazing or indirectly through the consumption of fodder and feed grain by livestock. Nevertheless, the top three countries by livestock numbers – Spain, the UK and France – have livestock units per hectare that are close to, if not higher than, Hungary's.

Hunland Trade is a major player in the food supply chain in selected markets

Thanks to an active role in livestock and meat trade for more than 25 years, Hunland Trade is a major player in global food supply. It sells to around 40 countries, mainly in Europe. In the EU, Hunland Trade is a leading exporter of breeding cattle to the Commonwealth of Independent States[4].

Leading Hungarian livestock exporter

Hunland Trade's cattle exports account for around 50% of Hungary's cattle exports, following by pigs (35%-50%), and sheep and goats (35%-50%). This makes the company Hungary's leading livestock exporter. Hunland Trade is also first in Hungary for net sales, followed by its two main competitors, Agrar-Coop and Agrota-2L.

Integrated business…

At least one-third of Hunland Trade's 10 main suppliers are sister companies: Hunland Production Kft, Bovinia Kft, Hunland Trans Kft and Hunland Chile Ganadera Ltd. The former three are also guarantors of Hunland Trade's bond issued under the Hungarian Central Bank's Bond Funding for Growth Scheme. These four suppliers represented 50% of the top 10 suppliers in terms of turnover in 2022. According to Hunland Trade, the

[4] Azerbaijan, Armenia, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Uzbekistan and Ukraine

other suppliers work to high standards as they are EU-approved slaughterhouses, meat processors and breeding companies.

…which protects Hunland Trade from economic downturns

Thanks to its vertical business integration into Hunland Group, Hunland Trade is somewhat less exposed to economic downturns and can deal better with the current economic environment.

Large customer base with some concentration

Around 50% of Hunland Trade's sales are realised in four countries (Hungary, Israel, Egypt and Turkey). It has customers in around 40 countries overall. Its top 10 customers account for 35%-50% of total sales and the largest customer (in Hungary) represents 30%-50%. The company faces some concentration risk.

High receivables

Hunland Trade's receivables account for almost half of its total balance sheet on average. To reduce the risk of non-payment, Hunland Trade uses credit insurance for EU sales and letters of credit for non-EU sales.

Foreign exchange risk

Due to the nature of its business and its partners worldwide (clients but also suppliers), Hunland Trade is exposed to foreign-exchange risk as more than 60% of its revenue is in euros. In order to mitigate this risk, it uses foreign-exchange forward contracts. When it makes purchases in US dollars, they are covered by revenue in US dollars.

The bond issued under the Bond Funding for Growth Scheme is labelled in forint while Hunland Trade's functional currency is the euro. The company used cross-currency interest swaps in order to hedge interest payments. However, it will be exposed to exchange rate risk at the end of the swaps when the principal will be exchanged back.

Revenue and EBITDA mainly dependent on livestock activity

Livestock consistently accounts for around 90% of revenue and 85% of EBITDA, followed by meat at around 5%-10% and 10%, respectively. As both activities relate to the same market category, we do not consider revenue to be diversified by sources. Nevertheless, diversification is strong by livestock type, with 50%-65% of total sales from cattle, 20%-30% from pigs and 5% from lamb.

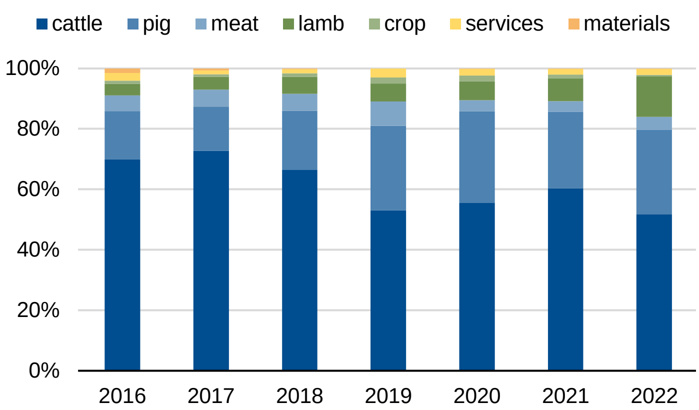
Good geographical diversification on the buyer side but …

On average, half of sales are realised in four countries (out of around 40 countries). Hungary is now the most important market. Previously it was Turkey, which accounted for around one-third of sales until a contract ended mid-2018.

… low geographical diversification on the supplier side

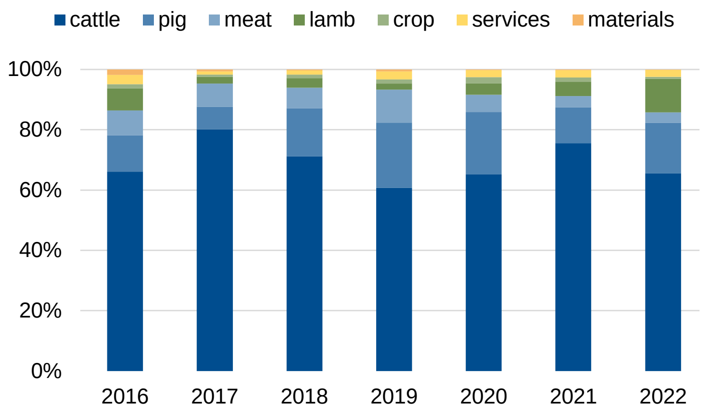
Half the supply come from Hungary, typically from sister companies, and the rest from about 20 other countries.

Figure 1: Sales breakdown by product



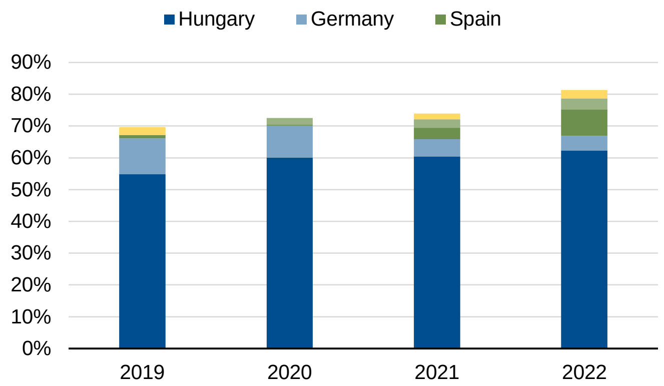
Source: Hunland Trade, Scope

Figure 2: EBITDA breakdown by product



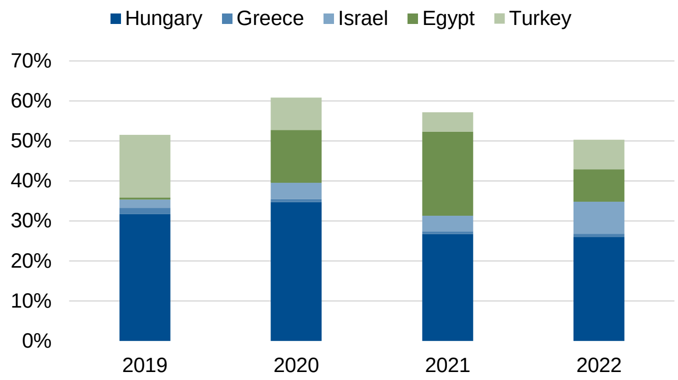
Source: Hunland Trade, Scope

Figure 3: Main origin countries (% of total sales)



Source: Hunland Trade, Scope

Figure 4: Main destination countries (% of total sales)

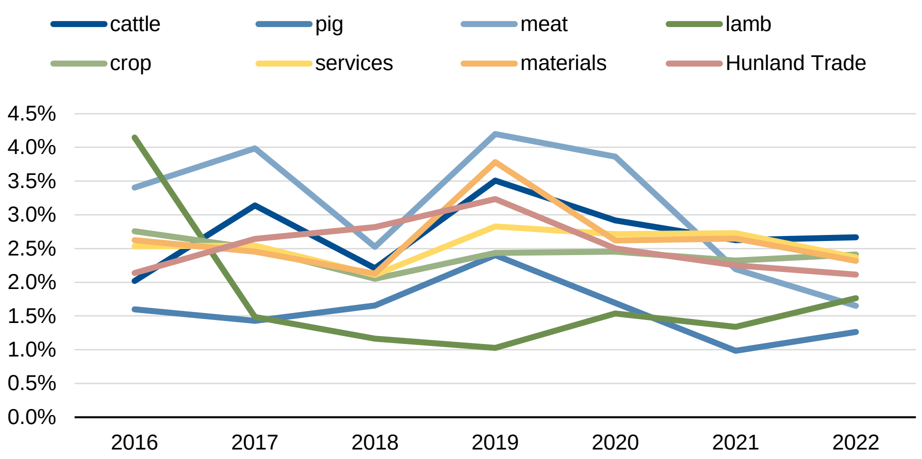


Source: Hunland Trade, Scope

Low profitability

Hunland Trade's EBITDA margin is low at 2%-3%. The highest margin is usually for meat followed by materials. Cattle, which accounts for the bulk of EBITDA, only has the third highest margin.

Figure 5: Adjusted EBITDA margin per segment



Source: Hunland Trade, Scope

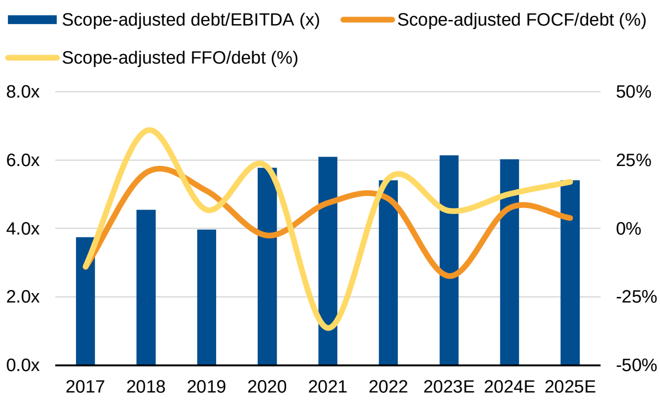
Margin profile expected to remain stable

Hunland Trade's profitability is set to remain stable after decreasing to 2.1% in 2022 mainly as a result of higher material costs and the change in accountability for other revenues (a large part has been integrated to revenues). We expect Hunland Trade's EBITDA margin to remain at around 2.0%.

Financial risk profile: BB

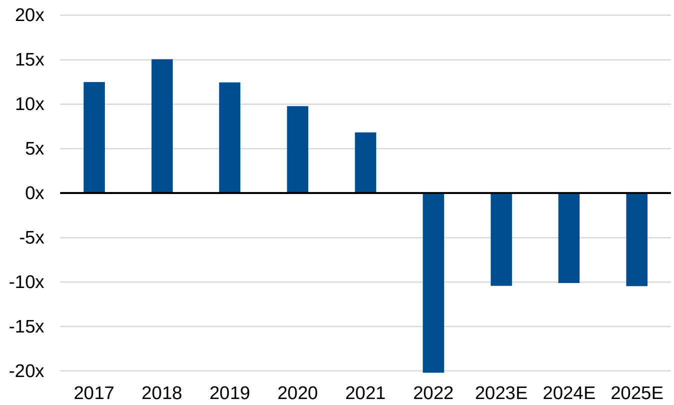
Hunland Trade's financial risk profile is based on our expectation of financial leverage (Scope-adjusted debt/EBITDA) between 5.0x-6.0x and sustained negative net interest paid. We also expect positive FOCF, except in 2023.

Figure 6: Scope-adjusted leverage and cash flow cover



Source: Hunland Trade, Scope (estimates)

Figure 7: EBITDA interest coverage*



*Negative ratios from 2022 to 2025 result from the negative net cash interest paid position.

Source: Hunland Trade, Scope (estimates)

High leverage

Before 2020, Scope-adjusted debt/EBITDA has been moderate at between 3.5x and 4.5x. In 2020, it increased to 5.8x due to lower sales and lower EBITDA while in 2021 it increased to 6.1x following the bond issue in July 2021. In 2022, this ratio improved to 5.4x mainly due to the depreciation of the forint relative to the euro, which led to a lower reported value in euro for the bond issued under the bond scheme that is labelled in forint. Our rating case includes expected Scope-adjusted debt/EBITDA of between 5.0x and 6.5x, with a progressive improvement in the coming years.

The Scope-adjusted funds from operations/debt ratio has been above 5%, except for 2017 and 2021 when it was negative. We expect this ratio to be at the higher end of the 0%-20% range based on a positive change in current assets and liabilities.

Very strong interest coverage

Hunland Trade's debt protection – as measured by Scope-adjusted EBITDA/interest – was above 10x (2017: 12x, 2018: 15x, 2019: 12%). Following the bond issue, debt protection deteriorated to 6.8x. In 2022, this ratio turned negative due to negative net cash interest paid. This improvement resulted from to the use of cross-currency interest rate swaps which were progressively implemented in the course of 2022. Those swaps enabled Hunland Trade to pay interest in euro instead of forint as it swapped the notional amount in forint to euro. However, as the base interest rate difference between euro and forint was significant, the swaps resulted in negative interest rates in euro (-0.8% on average) meaning that Hunland Trade has been actually receiving interest instead of paying it. As a result, forecasted interest payments should remain negative.

Weak cash flow coverage

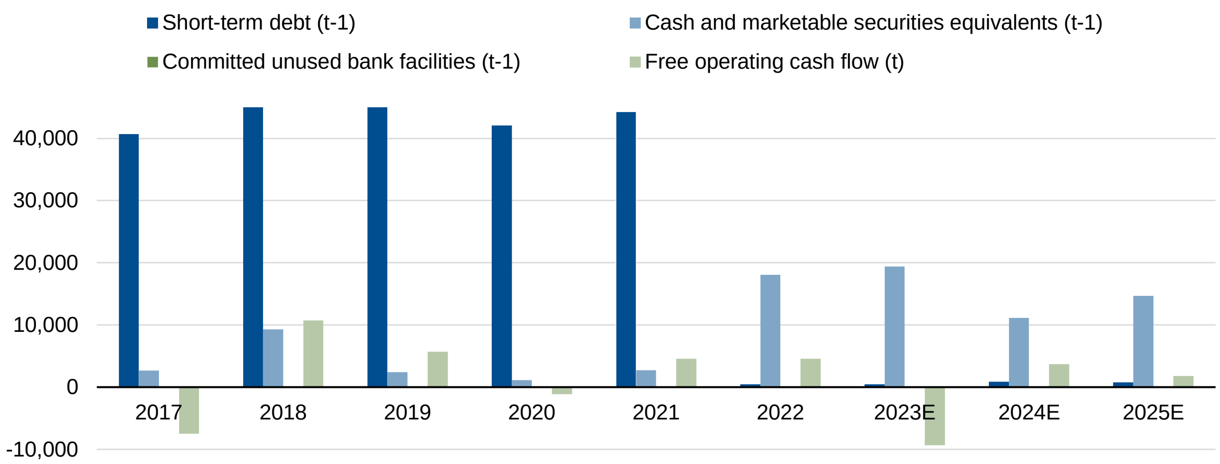
Hunland Trade's cash flow cover – as measured by Scope-adjusted FOCF/debt – has been moving between negative and positive positions due to the fluctuation in FOCF over 2017-2022. The variation is mainly influenced by the change in working capital. For the coming years, we expect FOCF to be negative in 2023 only.

Adequate liquidity

Hunland Trade's liquidity is adequate thanks to the bond issuance, which enabled the company to refinance the bulk of its short-term financial debt. Hunland Trade repays EUR 452,000 in debt in 2023. This compares to EUR 19.4m of available cash and equivalents as of 31 December 2022. In 2024, we expect the company to cover its short-term financial debt of EUR 904,000 (mainly composed of financial leases) by expected available cash and equivalents of EUR 11.2m at YE 2023 and FOCF of EUR 3.7m expected for 2024. As for short-term debt expected to be repaid in 2025 (EUR 773,000), it would be largely covered by the expected cash and equivalents of EUR 14.7m at YE 2024 and expected FOCF of EUR 1.8m in 2025.

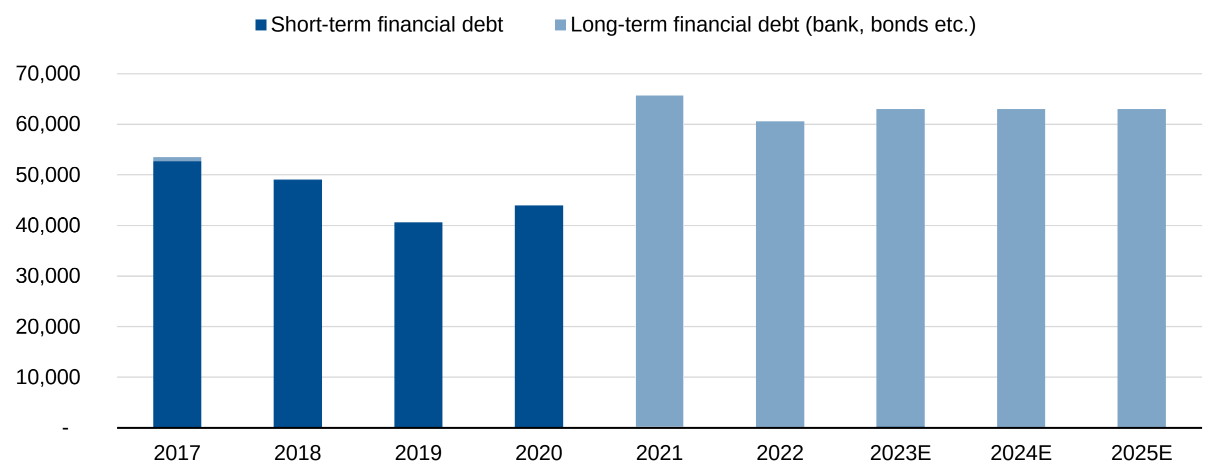
We highlight that Hunland Trade's guaranteed senior unsecured bond issued under the Hungarian National Bank's Bond Funding for Growth Scheme has a covenant requiring the accelerated repayment of the outstanding nominal debt amount (HUF 24.2bn) if the rating of the bond stays below B+ for more than two years (grace period) or drops below B- (accelerated repayment within 30 days). Such a development could adversely affect the company's liquidity profile. Following the upgrade of the rating, the rating headroom to entering the grace period is 1 notch. Hence, we currently see no significant risk of the rating-related covenant being triggered.

Figure 8: Short-term debt repayment amount, available cash and FOCF (in EUR '000s)



Source: Hunland Trade, Scope (estimates)

Figure 9: Financial debt (in EUR '000s)



Source: Hunland Trade, Scope (estimates)

Balance in EUR '000s	2023E	2024E	2025E
Unrestricted cash (t-1)	19,426	11,117	14,699
Open committed credit lines (t-1)	0	0	0
Free operating cash flow (t)	-9,309	3,726	1,798
Short-term debt (t-1)	452	904	773
Coverage	**>200%**	**>200%**	**>200%**

Supplementary rating drivers: +/- 0 notches

Conservative dividend policy

No dividends have been paid since 2017. Further, the bond prospectus states that there will be no dividend payments until 2022. Any dividend payments from 2023 would be capped at 50% of net income from the previous period and contingent on positive FOCF. This dividend policy is deemed as conservative. A higher dividend distribution could alter our rating case.

No credit-negative governance-related aspects

Hunland Trade is a privately owned limited liability company (Korlátolt Felelősségű Társaság, or Kft). The highest decision-making body is the members meeting (taggyűlés), whose members are the two owners: Joseph and Suzanne Janssen.

We see limited risk related to Hunland Trade's governance. The company's governance is also supported by experienced and committed management.

Long-term debt rating

HUF 24.2bn guaranteed senior unsecured bond issued for refinancing and intercompany loans

The rated entity issued a HUF 24.2bn (equivalent to EUR 65.6m) guaranteed senior unsecured bond in 2021 under the Hungarian National Bank's Bond Funding for Growth Scheme. It has a 10-year maturity with a five-year grace period followed by amortisation of 10% for years 5-9 and 50% in year 10. The bond was guaranteed by Hunland Trade's sole subsidiary (Hunland Trans Kft) and three sister companies (Bovinia Kft, Hunland Production Kft and Hunland Dairy Kft). Following the demergers, the current new guarantors are the following entities: Hunland Trans Kft, Bovinia Kft, Hunland Production Kft, Hunland Dairy Kft, HLT Production, Hunland Service, HLT Telep, Hunland Feed and Hunland Group Holding.

The proceeds were primarily earmarked for the refinancing of short-term financial debt of EUR 40m, the investment of EUR 3m in new production machines, and the provision of intercompany loans to the guarantors for EUR 20m to refinance debt (EUR 10.9m) and finance capex (EUR 9.1m).

Proceeds from the intercompany loans were earmarked as follows:

- Hunland Dairy: EUR 2.5m for capex to build a slurry storage unit and renovate its barn;
- Hunland Trans: EUR 4.5m for capex to acquire new assets/vehicles;
- Hunland Production: EUR 1m for capex to expand the feed factory and EUR 8.2m to refinance loans; and
- Bovinia: EUR 1.1m for capex to construct two new stables and EUR 2.7m to refinance loans.

In practice, the proceeds are used as follows:

- EUR 44.3m to refinance Hunland's short-term bank debt;

- EUR 8.2m to refinance Hunland Production's bank debt;
- EUR 2.7m to refinance Bovinia bank debt;
- EUR 5.5m to finance Bovinia's capex; and
- EUR 0.8m to finance Hunland Dairy's capex.

Thus, EUR 10.9m has been used to refinance guarantors' bank debt and EUR 6.3m is dedicated to financing guarantors' capex, meaning that a total of EUR 17.2m is dedicated to the guarantors. Overall, EUR 61.5m has been assigned to a specific purpose, which leads to an unused amount to be seen as a cash buffer according to Hunland Trade.

Bovinia and Hunland Dairy investments are prioritised as those entities' investment projects can benefit from government subsidies (40%-50%). Hunland Trade's investment has been postponed, leading to higher-than-expected bank debt refinancing.

BB- bond rating reflects above-average recovery expectation

Our 'above average' recovery expectation for guaranteed senior unsecured debt is based on an anticipated liquidation value in a hypothetical default scenario. The guaranteed senior unsecured bond ranks below short-term and long-term debt raised from financial institutions (excluding the bond issue) and payables that are secured by asset pledges. Consequently, in a hypothetical default, creditors of the guaranteed senior unsecured bond are likely to be repaid from the liquidation proceeds remaining after repayments to senior secured debt creditors. Our recovery expectation takes into consideration uncertainties regarding the value of claims at the guarantors' level as the value of claims at default is strongly driven by short-term assets such as inventory, receivables and financial assets whose value is deemed as uncertain at default. The recovery expectation also uncertainties about the debt positions of the guarantors at the point of a hypothetical default of the rated entity and the seniority of the claims. Thus, we have refrained from granting any notch uplift. These recovery expectations translate into a rating of BB-, reflecting the issuer rating upgrade.

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